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TESS - Q4 2015 TESSCO Technologies Inc Earnings Call

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## CORPORATE PARTICIPANTS

**David Calusdian** *TESSCO Technologies Incorporated - Investor Relations, Sharon Merrill*

**Robert Barnhill** *TESSCO Technologies Incorporated - Chairman and Chief Executive Officer*

**Aric Spitulnik** *TESSCO Technologies Incorporated - Chief Financial Officer*

## CONFERENCE CALL PARTICIPANTS

**Anil Doradla** *William Blair & Company - Analyst*

**William Dezellem** *Tieton Capital Management - Analyst*

## PRESENTATION

### Operator

Good day, ladies and gentlemen, and welcome to the Fourth Quarter 2015 TESSCO Technologies, Incorporated Earnings Conference Call.

My name is Connie and I will be your event operator for today. At this time, all participants are in listen-only mode. We will conduct a question and answer session toward the end of the conference.

(Operator Instructions)

And now, I would like to turn the call over to David Calusdian from Sharon Merrill. Please proceed, sir.

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**David Calusdian** - *TESSCO Technologies Incorporated - Investor Relations, Sharon Merrill*

Good morning, everyone, and thank you for joining TESSCO's conference call today. Joining me today are Robert Barnhill, TESSCO's Chairman and Chief Executive Officer; Aric Spitulnik, Chief Financial Officer; Craig Oldham, Vice President of Marketing; and Steve Tom, Vice President of Pricing and Analytics.

Please note that management's discussions today will contain forward-looking statements about anticipated results and future prospects. Forward-looking statements involve a number of risks and uncertainties and TESSCO's results may differ materially from those discussed today. Information concerning factors that may cause such a difference can be found in TESSCO's public disclosures, including the company's most recent Form 10-K and other periodic reports filed with the Securities and Exchange Commission.

With that introduction, I'd like to turn the call over to Bob Barnhill, TESSCO's Chairman and CEO.

Bob?

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**Robert Barnhill** - *TESSCO Technologies Incorporated - Chairman and Chief Executive Officer*

Good morning. Thank you for joining us on the call. Today, Aric and I want to provide you with an overview of where we are and where we are going to regain revenue growth and profitability. I'll give you a quick overview and tell you what we are seeing in the carrier market. Aric will then give you the details of our performance and I'll hop back in to discuss the successes of our growth initiatives.

Our fourth quarter and fiscal year 2015 results were disappointing, primarily as a result of the dramatic pull back in purchases from our wireless carrier customers, tentativeness from our private system operator customers, and the higher talent and technology investments we are making



to execute our growth initiatives. These results, however, do not reflect the progress we are making to minimize carrier concentration, renew growth and improve profitability.

First let me give you what we are seeing in the carrier market. There continues to be much conversation about the ongoing slowdown in the United States carrier builds and their associated spending. It has certainly impacted our business along with many other suppliers.

Overall, most of our customers and manufactures continue to experience a pull back in spending from the customers. While we saw slight uptick in the past two months, it is still quite soft compared to prior years. While no one exactly is clear on when spending will resume to historic levels, we're confident that it will rebound because of the need for ongoing infrastructure upgrades in order to satisfy the end users' insatiable demand for reliable wireless voice and data communications everywhere and anywhere

We're expecting carrier construction activity to increase as the year progresses. As building and spending does resume, we feel we're well positioned to capture share within all of our segments of the carrier ecosystem, including the carriers themselves, OEMs, program managers, general contractors, integrators and tower owners.

Additionally, we are ready to serve a range of infrastructure system needs, including macro sites, DAS, wireless backhaul, carrier Wi-Fi and small cell deployment.

So with that, I'll turn it over to Aric to give you the details of our performance and expectations for the new fiscal year. Aric?

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**Aric Spitulnik** - *TESSCO Technologies Incorporated - Chief Financial Officer*

Thanks, Bob. For the fourth quarter of fiscal 2015, revenues were \$113 million, compared with \$125 million year ago. The largest decline was in the public carrier market, which was down \$11 million or 33% year-over-year. Excluding the carrier market, the remainder of the business was essentially flat from the fourth quarter of the prior year.

Gross profit was almost \$27 million in Q4 compared with \$30 million in last year's fourth quarter. Gross margin was 24.5% compared with 24.2% a year ago. The increase in gross margin was primarily the result of improved customer and product mix.

SG&A expenses were \$27.4 million, up 8% from the fourth quarter of 2014, primarily due to increased investments in talent and technology. In addition, we incurred a restructuring charge of \$600,000 relating to severance costs. As a result, operating margin was negative 0.3% versus a positive 3.8% in the prior-year quarter.

We continue to make critical investments to drive future growth. At the same time, we expect the restructuring efforts we implemented in 2015 and the continuation of our value engineering initiatives to have a positive effect on operating margins beginning in the first quarter of fiscal 2016.

Finally, one of the key tenants of our compensation cost is pay for performance. Our results in fiscal 2015 were obviously not what we were expecting when the year began and therefore, no cash or equity bonuses were earned for management. For fiscal 2016, no bonuses will be earned at the low end of the guidance range and less than half of management's potential bonuses will be earned at the high point.

This reflects our understanding that we still have work to do to achieve the profitability targets that we have come to expect.

In addition, in fiscal 2016, we are better aligned in compensation for all of our business generation teams with their corporate goals.

Net loss for the quarter was \$200,000 or \$0.03 per share, down from net income of \$3 million or \$0.35 in the same quarter a year ago. Excluding the restructuring charge, net income was \$100,000 and EPS was \$0.01.



Now, turning to the markets. In the public carrier market, revenues were down 33% year-over-year and gross profit was down 26%. We expect this slowdown to moderate during fiscal 2016, and while the precise timing is yet unclear, we do expect at least a modest sequential growth in Q1 and more in Q2.

In the government system operators market, sales increased 11%, while gross profit increased 6% year-over-year. We have seen increased demand for the maintenance and operations on land, mobile and radio networks, which has resulted in increased sales of their related products. We've also made considerable investment in this market and expect to see strong growth in fiscal 2016.

The commercial dealer and reseller market, revenue decreased 10% and gross profit fell 8% from a year ago. Much of this decline relates to the lower carrier purchasing through these resellers. In the private system operators market, revenue declined 3%, while gross profit decreased 8%.

Turning to the retail market, the combination of the new Samsung phone launch and iPhone 6 sales helped produce solid revenue growth of 7% with gross profit rising 1%.

As we've discussed previously, one large tower owner customer has paid for but asked us to hold a large amount of inventory in our facility until they deploy it, at which time we can recognize revenue associated with it.

During Q4, we recognized almost \$1 million of revenue associated with this inventory. And we currently still have about \$6 million remaining to be recognized. This revenue will continue to be recognized over time as the inventory is utilized and we expect the vast majority of it to be recognized sometime in fiscal 2016.

Cash flow from operations was \$1.2 million during the fourth quarter. Overall cash on the balance sheet was \$7.5 million and we had no balance on our \$30 million line of credit. We remain committed to our dividend program and we've set our dividend of \$0.20 per share with a record date of May 20 and a payment date of June 3.

Now turning to our earnings outlook, we expect the first quarter of fiscal 2016 to continue to be challenging in the phase of persistent softness in the carrier market. As a result, we're providing guidance of \$0.08 to \$0.15 per share for the first quarter. However, we expect gradual improvement as the year progresses in both the carrier market and other key markets and we estimate fiscal 2016 EPS of \$1 to \$1.25.

The low end of the guidance range anticipates very modest revenue growth, with continued softness in the carrier market offsetting growth in the other markets. The upper end of the range assumes improved carrier market demand and growth in the other markets. In both cases, sales from our largest customer in 2015 will be down as they work off on-hand inventory during 2016.

I'll now turn it back over to Bob to discuss the growth initiatives for 2016.

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**Robert Barnhill** - *TESSCO Technologies Incorporated - Chairman and Chief Executive Officer*

Thanks, Aric.

Today, we are taking aggressive actions to minimize the carrier concentration, renew growth and improve profitability. TESSCO is focused on moving beyond the carrier concentration by serving new markets with solutions for the new systems being created by the convergence of wireless and internet.

Our most important goal is to make the difference in our customer success and as a result build superior shareowner value. To achieve our goal, we are executing on four key initiatives which are the roadmap for renewed revenue growth and profitability. Let me summarize the initiatives and outline the successes we're seeing.

First is value engineering our organization, policies and procedures. We are working to simplify and standardize our policies and procedures to deliver an extraordinary experience at every link in the value chain to better serve the customer and to improve our productivity.

As an example, shortly we will be rolling out the new policies on tessco.com to empower customers to manage their procurement and accounts more efficiently. Doing this will allow us to scale our business productively and give our sales force more time to spend with the customer. We are shaping the organization to enhance our culture of excellence, collaboration, accountability and performance.

The market development in sales, strategic marketing and solutions development at product management units have and are going through important reorganization to gain more focus and effective offer development, opportunity creation, customer satisfaction and sales, all with higher productivity.

We're also working to improve the operating income margin by value engineering initiatives and remaining intensely focused on overall expense control.

As Aric explained, we did some restructuring in quarter four and are continuing to find areas to lower cost.

The second initiative is to develop and offer the end-to-end product and supply chain solution. Considerable progress is being made to expand our offer to enable customers to build, use, maintain and resell their wireless systems.

Historically, TESSCO has been the product supplier for base station infrastructure, mobile communications, cellular devices, remote monitoring and control and testing installation and maintenance products. To continue to improve our offering in these areas, we are aggressively developing the solutions to support the new systems emerging.

Let me quickly walk you through the new systems we're supporting.

Enhanced Cellular Capacity and Coverage, DAS, which was huge in quarter four of fiscal year 2014 and the first half of fiscal year 2015 and it's slowed dramatically in the second half of the year. We expect this to come back strong, but the question is when? We know users want to improve cellular performance in buildings and in large venues.

Wi-Fi networks is now a major focus for us. We're adding exciting new manufacturer's products and we're creating new proprietary Ventev Wi-Fi antennas and enclosures. Internet of Things, this is the control of homes, building, air-condition, security and so on. We're just beginning to build out the product offering and to integrate it within a Wi-Fi system offer.

Wireless backhaul, point-to-point, point-to-multipoint and MAX systems are increasingly becoming the backbone for remote monitoring and control, lease line replacement and data -- wireless data transfer. We are also exploring wireless backhaul solutions for small cell deployment.

Machine-to-machine, this is the expansion of industrial remote monitoring and control, which includes remote oil and gas monitoring, security and video surveillance system and communications site monitoring. In the coming months, we are launching a host of new industrial end-to-end solutions, which will solve the customers' remote monitoring and telematic challenges at what we call the Edge.

This past quarter, we finalized contracts with vendor partners to be a part of these new TESSCO solutions. We anticipate a launch of the initial set of solutions in the coming months and we're particularly excited about the opportunities we are pursuing in tank and fleet monitoring and asset tracking.

Our advantage in providing customers end-to-end system solutions is that we couple our expertise and experience in wireless backhaul to transmit the edge device and sensor data back to the data and control center.

As we develop new end-to-end solution offerings, we require new products from new OEMs, our manufacturing division Ventev and possible acquisitions. In the past year, we added over 30 new manufacturers to our portfolio, Samsung, GE Critical Power, and Linksys just to mention a few, along with new Ventev Wi-Fi and mobile device power products.



While we add new products, I'll say that we are optimizing and appropriately discontinuing items in our existing offer. Market forces are requiring manufacture to decrease their inventory and decrease the inventory in the channel. This will ultimately be a positive change and will help TESSCO make the supply chain even more efficient.

To this end, we continue to work on deepening our relationships with our existing manufacture partners. As an example, recently OtterBox, the top brand in the industry for protective smartphone cases and our largest mobile device accessory manufacturer, significantly consolidated its distribution channel by naming TESSCO as one of the only five distributor partners.

TESSCO was chosen because of our overall value proposition, our small and large customer reach and our capacities and capabilities in demand, planning and forecasting. We've already seeing a slight uptake in first quarter sales directly related to the OtterBox supply chain consolidation.

As we discussed previously, another key vendor, CommScope, consolidated its distributor base in November, selecting TESSCO as one of its four wireless distributors. OtterBox and CommScope serve as the confirmation that TESSCO is well positioned with customers and manufactures for providing the end-to-end product plus the supply chain solution. Due to the timing of Otter and CommScope consolidations, neither of these had a significant impact on fiscal year 2015 sales. However, we expect both relationships to be revenue drivers in this coming year.

The delivery of an end-to-end solution depends on a superior supply chain as well as the required products. We are enhancing our operations to provide more seamless, reliable product purchasing and availability, delivery of the configured end-to-end solution fulfilled and delivered, complete and error free, when and where required and making sure that we are compensated for the value we are delivering.

We're also aggressively working with our manufacturer to improve their availability, provide direct factory fulfillment when required, reliable delivery and lower landed cost.

The third initiative is our relationship solution selling. We are well on our way transitioning from reactive selling to proactive relationship end-to-end solution selling to improve the customer experience and grow customer strategic relationships, cross-selling and generate sales.

We have been reorganizing the sales force with strong key performance expectations, opportunity and results tracking and compensation reward programs to better serve and penetrate each of our customer segments.

Preparing for the improvement in the carrier market and the many new opportunities in the industrial and enterprise, private systems, government, VAR and retail markets, we have augmented our leadership and sales team with experienced talent.

While we develop the relationship selling, we're also enhancing our internet tessco.com transaction sales and service channel, which I will address shortly. This past year, we made significant technology and training investments to transform our sales force. The initiative has taken longer than we expected. However, we're seeing very encouraging successes as we begin our new year.

We're now working closely with a number of key customers to support their growth opportunities by delivering complete supply chain solutions as well as required products. Many of the customers are in the carrier space, so revenue growth we expect from these relationships will not be realized until the market improves. These projects, however, provide us with clear validation that our offer is what our customers need and want.

The last initiative is the data and digital marketing and sales system. A significant portion of our investment in cost has been to develop what we call the scientific high tech, high touch marketing and sales system. This system is beginning to deliver predictive analytics, competitive intelligence, one-to-one customer contextual communications, opportunity creation, sales force guidance and tracking and TESSCO productivity and obviously a very extraordinary customer experience.

You may have noticed we updated the homepage on tessco.com Wednesday evening. Launching the new homepage marks a big milestone on our journey to redesign tessco.com. When completed, our new tessco.com experience will be faster, deliver more personalized contextual experience and make it easier for the customer to gain knowledge, procure and manage their account, and it gives our customers, as well as our sales team, the ability to place orders directly on tessco.com.



The specific components of our system begin with predictive analytic big data and this is a component which provides recommendation, product recommendation alternatives, customer product forecast, identifying at risk business and identifying possible product availability problems. Today, our big data engine is delivering actionable insights to our 200 plus team members on a daily basis, helping them target and prioritize their activities. It's also providing retail point of sale analytics, delivering localized recommendations to our resellers of products [the stock and at what] levels.

The second component of the scientific marketing system is obviously tessco.com and ventev.com, making both of these sites a definitive place to learn and procure. The one-to-one go to market campaign and communication and opportunity creation engine, the opportunity pursuit and optimize our sales guidance system, manufacturing and marketing services, performance and results tracking. Results from our scientific marketing and sales system are emerging and we expect to see accelerated results as the new features come online.

In summary, as we embark on fiscal year 2016, TESSCO is in a strong position to capitalize on the new opportunities and respond to the carriers when their network construction accelerates.

Our opportunities are boundless, our strategy and initiatives are solid and we are committed to improving profitability in the short run, while achieving the revenue and profit growth performance we all expect in the longer run. We're working hard to turn our goals into reality.

We'll now open the line for any questions you may have.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions)

Your first question comes from the line of Anil Doradla from William Blair. Please go ahead.

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**Anil Doradla** - *William Blair & Company - Analyst*

Hey.

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**Robert Barnhill** - *TESSCO Technologies Incorporated - Chairman and Chief Executive Officer*

Good morning, Anil.

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**Anil Doradla** - *William Blair & Company - Analyst*

Thanks a lot from me.

So a couple of questions guys. Clearly, the December quarter we saw a 39% year-over-year decline, followed by March quarter which is 33%. So it's almost like the business is almost half. I'm just trying to understand the dynamics, you did talk about the service provider pause, it's something we've heard across the board.

But I really would like to understand, you know, such a dramatic pause, is this something, first of all, have you seen ever before? I can't think of a time when I saw it in your business. And can you talk around that qualitatively, which applications and end markets within the public area or service provider spending you're seeing weakness?



**Aric Spitulnik** - *TESSCO Technologies Incorporated - Chief Financial Officer*

Hey, Anil. It's Aric.

You know, the last third and fourth quarters were good quarters for DAS as well as the carrier, you know, the more traditional carrier spend. So what we saw this year was the DAS went down as well.

So the drop is more than just the normal 4G build that was going on, so it affected the DAS spending as well this quarter more so than it had in the previous couple of quarters.

They were still pretty strong in the first half of the year and dropped off a little bit in the second half of the year.

We do expect that to pick up again as we get towards the second half of the year as well as the more traditional carrier business.

Anil, definitely, we've never seen -- I mean we've been servicing the customers since -- the carrier since 1983 and we've never seen such a dramatic sharp pull back. And, you know, part of it is driven by -- we're heavily concentrated with one particular carrier, today with the new people we brought in and the new initiatives, we're starting to really broaden out in the other carriers as well and go deeper and deeper.

But it's a very interesting, I mean, if you look at CommScope's announcements and what's happening with them, this has been the harshest pull back that we've ever seen in the history of cellular communications.

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**Anil Doradla** - *William Blair & Company - Analyst*

Okay, Barnie, now you talked about I think the low end of your guidance and high end predicated on obviously some of the business coming back, can you share with us, you know, how much booking or how much visibility do you have towards even the low end or give us some sense of how much confidence you have in your outlook?

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**Robert Barnhill** - *TESSCO Technologies Incorporated - Chairman and Chief Executive Officer*

Obviously, we're being extraordinarily conservative as we look forward.

The one particular carrier is not giving insight, at least to us, and to our manufacturers in terms of when they expect to continue to build. We're getting almost better insight with some of our other carriers in terms of where they are going. And one of the things that we're doing with this scientific marketing sales system we're talking about, we are developing a very extensive pipeline that we're using obviously for any type of projection as well as inventory, bringing inventory in.

So that pipeline is growing. We've got a very exciting pipeline that is there, but we've got make it come into reality.

I'd also say that there is some major meetings that are being held by the carriers to explain where they are going in terms of their transformation and what they expect us to be doing.

You know, we talked about that supply chain. We are working on some very exciting total supply chain solutions for the carriers and some of the tower contractors. So there is a huge amount of activity and the activity is -- obviously, we're continuing to invest in that activity and getting very good favorable comments, if you will, but where is the beef? And that's one of the challenging things.



**Anil Doradla** - *William Blair & Company - Analyst*

Great. And Barnie, you guys are obviously doing some restructuring, can you give us a sense of the number of personnel impacted by this and what areas of restructuring you are focusing on?

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**Robert Barnhill** - *TESSCO Technologies Incorporated - Chairman and Chief Executive Officer*

The major thing is that we're trading up in terms of -- you know, the talent we have in marketing, the talent we have in the solutions development, the talent we have in analytics, we've grown and then sales, we've grown so that it's -- you saw it was six hundred some thousand dollars last quarter, you know, we're going to see as we go forward a continued shaping. But it's more of getting the organization lean, we are leaning out the organization, this whole thing about policies and procedures is very important because if you don't have a standardized simplified policy, you need four or five people to make a decision.

You know, this is going to be kind of decision and the customer can get affected on the web. So it's a combination of -- if we can convert -- we've done time studies where we've shown our very experienced, capable, talented development executives are spending 50%, 60% of their time on the logistics issues, by us getting better policies and controls, that's going to allow them to divert their time out to the customer and that's being able to talk to more customers and have deeper relationships.

But all the way across the board, is that we are looking for how do we make the unit, you know, whether it'd be operations, whether it'd be more productive and how do we make sure we've got the right people in the right position to make that happen?

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**Anil Doradla** - *William Blair & Company - Analyst*

And Barnie, finally, if I can squeeze in one final one. When I step back and look at the big picture and look at just go for the last four, five years, obviously the company has done a great job of diversifying different applications, different customers. But in the last four, five years, if you look at the common headwind per se, it's been service providers. We've seen that in the handset side and now we're seeing in the infrastructure.

I think going through couple of these rough patches with service providers, do you take a second look at your business now or approach towards service providers? I know it's a big portion. It's important. But how do you handle this given that every two to three years, we're seeing some very dramatic pause not due to your mis-execution or competitive, but purely the whims and fancies of service providers so to speak.

So how do you look at this business and what are you planning to do to perhaps moderate the influence of some of these large variabilities?

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**Robert Barnhill** - *TESSCO Technologies Incorporated - Chairman and Chief Executive Officer*

You have phrased it extraordinarily well. Everything that I was talking about is how do we diversify from the carriers.

And when we look at these private systems because of the convergence of wireless and the internet, people are doing their own systems, they have their own private systems and we have to be there.

And what has happened, we've been working on these initiatives, but there tends to be the magnet that goes back to the carrier and we haven't executed them as quickly as we need to do.

And with the product offerings we have, the solutions offering we have and the people we now have and then with the marketing, the analytics, we're finding opportunities that we never even knew existed. And long-winded story is that this year and next year we want to convert that 30 plus percentage business that is related to the carriers and make that -- we want to grow the top line, but make that a much smaller percentage of our business.

And the opportunity is there, it's not like we got to reinvent the world in terms of the same products, the same supply chain is what we need, whether we serve in a railroad, or your utility, or an enterprise, a school district and that's where we are headed and that's where we are going.

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**Anil Doradla** - *William Blair & Company - Analyst*

Okay, thanks.

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**Operator**

Thank you.

(Operator Instructions).

Your next question comes from the line of Bill Dezellem from Tieton Capital Management. Please go ahead.

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**William Dezellem** - *Tieton Capital Management - Analyst*

Good morning.

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**Robert Barnhill** - *TESSCO Technologies Incorporated - Chairman and Chief Executive Officer*

Good morning, are you there?

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**William Dezellem** - *Tieton Capital Management - Analyst*

I'm here. Can you hear me now?

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**Robert Barnhill** - *TESSCO Technologies Incorporated - Chairman and Chief Executive Officer*

Yes, thanks. How are you?

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**William Dezellem** - *Tieton Capital Management - Analyst*

I'm well. Thank you, my apologies for operator error on my end.

You've listed off a number of initiatives that you are in process of working on, many of which your multiyear initiatives, would you dial it into the one or ones, is that you believe will have the most impact on fiscal 2016, please?

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**Robert Barnhill** - *TESSCO Technologies Incorporated - Chairman and Chief Executive Officer*

Sure. And these initiatives are not ones that -- I meant they are, as we've explained in previous calls, we've been underway with these for three plus years and it's the acceleration that we are pushing. I mean, obviously we've got to get the robust offer and making sure that we've got all the components to do an end-and-end rather than just to sell them up for a cable. We've got to make sure that we've got the marketing system and the new world in terms of how -- what the customers expect is that digital world that they can go on, they can learn and they can place business and they can manage their account and then obviously the sales talent and the sales strategy to go.

And then underlying that is making sure that you've got those policies and procedures which come into the offer. I mean, number one is to get the sales force really effectively going after these new opportunities and making sure that we can consummate them and making sure that we have the pipeline that we know where we're going rather than sitting back waiting for a transaction or the phone to ring and you sell thousand feet of cable.

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**Operator**

Thank you. I'd now like to turn the call over to Mr. Barnhill for closing remarks. Please go ahead.

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**Robert Barnhill** - *TESSCO Technologies Incorporated - Chairman and Chief Executive Officer*

Thank you. Again, I will recognize that we're all disappointed with the results. But as we've said, we feel very confident as we look at the future and we look at the ability to execute these initiatives and these imperatives, the talent that we've acquired and that are part of the team now and some of the key talent is not even been with us for a year, is accelerating these goals that we've set for us that in the previous years we haven't accelerated and they have been achieved as fast as we wanted.

So we thank you for being on the call. We thank you for your support and we really look forward to executing on these initiatives and updating you on our achievements in the fiscal first quarter when we have the call in July. Thank you very much.

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**Operator**

Thank you, Mr. Barnhill.

Thank you for your participation in today's conference. This concludes the presentation. You may now disconnect and have a very good day.

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